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No. 98-630

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1998

ERIK J. HAMILTON,

Petitioner,

vs.

DOCTOR'S ASSOCIATES, INC.,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

REPLY TO BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

I. Whether the Federal Arbitration Act preempts general state contract law principles, applicable to all contracts, when an arbitration clause is included.

II. Whether the Federal Arbitration Act authorizes United States districts courts to compel arbitration of damage claims pending in previously filed, non-removable, state cases.

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ARGUMENT

I. Certiorari is required to distinguish the issues governed by federal policy from those governed by general state contract law principles.

Doctor's Associates, Inc. ("DAI") argues that Section 2 of the FAA (9 U.S.C. §2) preempts all state law contract principles affecting the validity and enforceability of arbitration clauses except state contract principles that apply to all contracts and not

state contract law principles that apply to all contracts of a specified kind, such as franchise contracts, consumer contracts, employment contracts, etc., relying upon Management Recruiters International, Inc. v. Bloor, 129 F.3d 851 (6th Cir. 1997), a Rutgers Law Journal article written by the attorneys for DAI and the decision below, Doctor's Associates, Inc. v. Hamilton, 150 F.3d 157 (2d Cir. 1998). (Brief in Opposition, pp. 8, 11, 13, 17). DAI argues that the FAA trumps the New Jersey Supreme Court's decision in Kubis & Perszyk Associates, Inc. v. Sun Microsystems, Inc., 680 A.2d 618 (N.J. 1996). (Brief in Opposition p. 17).

Petitioner, however, contends that New Jersey State contract law principles voiding choice of law and choice of forum selection clauses in New Jersey franchise contracts, applicable to both out-of-state litigation and arbitration, is not preempted by the Federal Arbitration Act.

This issue has not previously been addressed by this Court and the lowers courts are in conflict. In Doctor's Associates, Inc. v. Hamilton, 150 F.3d 157 (2d Cir. 1998), the court held that the role played by state law in FAA jurisprudence is so narrow that it was not necessary to determine which state law applied. (Appendix at pp. 10a, 14a). The Second Circuit also holds that "*** even the inclusion in the contract of a general choice-of-law clause does not require application of state law to arbitrability issues, unless it is clear that the parties intended state arbitration law to apply on a particular issue. Doctor's Associates, Inc. v. Distajo, et al., 107 F.3d 126, 130-31 (2d Cir. 1997).

In Charles S. Barker, et al. v. Golf U.S.A., Inc., 154 F.3d 788, 792 (8th Cir. 1998), the court elevated state law to the extent that it was applied to reject the federal separability doctrine established by Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395, 18 L. Ed. 2d 1270 (1967). The franchisees in the Charles S. Barker case filed a petition for a writ of certiorari to this Court, now pending as case No. 98-644.

Both DAI and the Second Circuit opinion below rely upon Management Recruiters Intern., Inc. v. Bloor, 129 F.3d 851, 855 (6th Cir. 1997). (Appendix, p. 12a; Brief in Opposition at p. 17, 18.) Management Recruiters Intern., Inc. v. Bloor, however, applied Washington state law to determine whether the Washington Franchise Investment Protection Act ("FIPA") prohibited choice of forum clauses requiring arbitration outside the State of Washington, finding that it did not. The court then proceeded to note in passing that if the Washington Franchise Act had prohibited out-of-state arbitration, its validity would be in serious doubt. Id. 856.

In the case at bar, however, New Jersey law clearly prohibits forum selection clauses requiring litigation outside the State of New Jersey for New Jersey franchisees operating franchise shops within New Jersey. Kubis & Perszyk Associates, Inc. v. Sun Microsystems, Inc., 680 A.2d 618 (N.J. 1996). It is submitted here that the New Jersey Supreme Court would clearly hold that forum selection clauses under the circumstance of this case requiring either litigation or arbitration outside of New Jersey are

void and unenforceable as conflicting with the public policy behind the New Jersey Franchise Act, N.J.S.A. 56:10-1 through 56:10 -15. See also Instructional Systems, Inc. v. Computer Curriculum Corp., 130 N.J. 323, 614 A.2d 124 (1992). The rationale behind the New Jersey Supreme Court's decision voiding litigation forum selection clauses leaves no doubt that it would arrive at the same conclusion about arbitral forum selection clauses. Kubis & Perszyk Associates, Inc. v. Sun Microsystems, Inc., 680 A.2d 618, 626, 627 (N.J. 1996); "We hold that such clauses are presumptively invalid because they fundamentally conflict with the basic legislative objectives of protecting franchisees from the superior bargaining power of franchisors and providing swift and effective judicial relief against franchisors that violate the Act.

A significant difference exists between the function of a forum-selection clause in an arms-length commercial contract and its function in a typical contract subject to the Franchise Act. ***

*** Although such a clause directly benefits the franchisor by requiring suit to be filed in a geographically convenient state of choice where it can be defended by the franchisor's regular litigation counsel, the indirect benefit to franchisors is to make litigation more costly and cumbersome for economically weaker franchisees that often lack the sophistication and resources to litigate effectively a long distance from home. *** Thus, if unchallenged by the franchisee, a forum-selection clause can materially diminish the rights guaranteed by the Franchise Act because the franchisee must assert those rights in an unfamiliar and distant forum, with

out-of-state counsel, and bear the added expense of litigation in the franchisor's designated forum."

Petitioner respectfully submits that, if permitted, the New Jersey courts would also have determined that the arbitration clause is void and unenforceable as unconscionable and against public policy for the reasons expressed in the Kubis v. Perszyk Associates, Inc. and Instructional Systems, Inc. v. Computer Curriculum Corp. cases. The American Arbitration Association requires payment of all fees and charges by both parties before permitting its arbitrators to issue an award. Erik Hamilton has insufficient funds to pay the approximately $20,000.00 required to obtain issuance of an arbitration award, if he were arbitrating in New Jersey, much less the approximately $32,000.00 that would be required for fees and expenses if he were required to arbitrate in Connecticut. Moreover, while requiring the franchisees to arbitrate their claims in Connecticut, DAI reserves the right to litigate its claims in the form of eviction actions filed by its alter ego, assetless leasing companies, which lease Subway sandwich shop locations from the landlords and sub-lease them to the franchisees. The sub-leases contain a cross-default clause making any breach of the franchise agreement by the franchisee, sub-lessee a breach of the sub-lease. The threat of eviction exposes the franchisee to the potential loss of his entire investment. Only the franchisees are required to arbitrate. The franchisor reserves the right to litigate. See Doctor's Associates, Inc. v. Distajo, et al., 66 F.3d 438 (2d Cir. 1995), cert. denied, 116 S. Ct. 1352 (1996); Doctor's Associates, Inc. v. Distajo, et al., 107 F.3d 126 (2d Cir. 1997), cert. denied, 118 S. Ct.

365 (1997); Yates v. Doctor's Associates, Inc., 549 N.E.2d 1010, 140 Ill. Dec. 359 (Ill. App. 1990); Cox v. Doctor's Associates, Inc., 613 N.E.2d 1306, 184 Ill. Dec. 714 (Ill. App. 1993), appeal denied, 622 N.E.2d 1202 (Ill. 1993), cert. denied, 510 U.S. 1118 (1994); Subway Restaurants, Inc., et al. v. Riggs, 696 N.E.2d 733, 231 Ill. Dec. 437 (Ill. App. 1998); Jannotta v. Doctor's Associates, Inc., 125 F.3d 503 (7th Cir. 1997).

While DAI argues that Erik Hamilton's position requires this Court to determine how the New Jersey Supreme Court would rule when faced with an arbitral forum selection clause, instead of a litigation forum selection clause, it should be noted that DAI precluded the New Jersey courts from determining this issue of New Jersey law by requesting and obtaining the Connecticut federal injunction barring the New Jersey state courts from determining the enforceability and validity of the arbitration clause.

The attorneys for DAI acknowledge that the law is unclear on this question. See Edward Wood Dunham, "Franchisor Attempts to Control the Dispute Resolution Forum: Why the Federal Arbitration Act Trumps the New Jersey Supreme Court's Decision in Kubis," 29 RUTGERS L.J. 237, 261 (Winter 1998). "*** A more difficult question arises when state law singles out a number of subjects, including arbitration, for special treatment. At what point, if ever, will there be enough other subjects so that the special treatment is considered part of the general law of the state? *** However, while it is probably true that 'at the present time the boundary of § 2's savings clause is unclear, these state

laws and judicial decisions are clearly on the wrong side of the line."

Petitioner respectfully submits that the decision below, holding that the FAA preempts general state law principles, applicable to all franchise contracts, with or without arbitration clauses, requiring litigation and/or arbitration within New Jersey under New Jersey law is on the wrong side of the line. Congress did not clearly intend for the FAA to override general state substantive laws applicable to specified types of contracts, such as franchise agreements, consumer contracts, employment contracts, etc.

Certiorari is required to clarify the limits of federal preemption under the FAA. Did Congress intend for the FAA to preempt general state contract law principles, applicable to all contracts of a specified type, which do not discriminate against arbitration clauses? There is a general presumption against preemption unless that was the clear and manifest purpose of Congress. Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230 (1947); Maryland v. Louisiana, 451 U.S. 725, 746 (1981); Cipollone v. Liggett Group, Inc., 112 S. Ct. 2608, 2617-18 (1992).

II. Petitioner's "lack of statutory authority" argument assumes, and does not challenge, federal diversity jurisdiction.

The court below concluded that Erik Hamilton's "absence of statutory authority" argument was a challenge to diversity jurisdiction. Doctor's Associates, Inc. v. Hamilton, 150 F.3d 157 (2d Cir.

1998); Appendix, p. 8a, 9a. DAI makes the same argument here. (Brief in Opposition, pp. 8-10). Yet Petitioner has repeatedly stated the issue as assuming the existence of federal diversity jurisdiction, and challenging the statutory authority under 9 U.S.C. §§ 3, 4 for a federal court, with diversity jurisdiction, to compel arbitration of damage claims pending in a previously-filed, non-removable state case. (Appendix, p. 8a; Petition for a Writ of Certiorari, pp. 10-15).

The issue raised here was not presented in Moses H. Cone Memorial Hospital v. Mercury Construction Corp., 460 U.S. 1 (1983) which concerned a prior non-removable state action for a declaratory judgment, not for damages, and did not involve a federal injunction against further prosecution of the state action. The decision below permits DAI to use Section 4 of the FAA and a federal injunction to accomplish something prohibited by Section 3 of the FAA, the use of one court to compel arbitration and stay litigation of damage claims pending in another court. After enjoining the New Jersey state court from determining the validity and enforceability of the arbitration clause, DAI complains to this Court that Erik Hamilton is asking it to determine an issue of New Jersey state law. The parties would have New Jersey's position on this issue by now but for the Connecticut federal injunction issued at the request of DAI.

Erik Hamilton submits that the validity and enforceability of the arbitration clause under New Jersey state law should be determined by the New Jersey state court in the pending New Jersey action

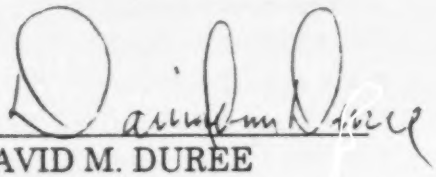
because 9 U.S.C. § 4 did not authorize the Connecticut federal court to compel arbitration of the damage claims pending in the previously-filed New Jersey state action. DAI has developed a technique which provides, in essence, federal jurisdiction of petitions to compel arbitration under 9 U.S.C. § 4 in almost every case by filing a federal action between two diverse parties in a prior pending, multi-party, state action followed by a federal injunction against the entire state action. If Congress had intended to provide federal jurisdiction of petitions to compel arbitration under Section 4 of almost all prior pending, non-removable, state damage claims, it simply would have provided independent federal jurisdiction for actions under 9 U.S.C. § 4. It did not do so because it did not intend for the FAA to enlarge federal jurisdiction.

Petitions to compel arbitration and to stay litigation of previously filed state damage claims should be filed in the state courts under the substantive parts of the FAA (§§ 1 and 2) and state procedural rules, which do not require that petitions to compel be filed in the geographical locations where arbitration is to occur.

CONCLUSION

For the reasons stated, the Petition for a Writ of Certiorari should be granted.

Respectfully submitted,



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